SUPREME COURT, U. S.
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In the Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-1237

THE AETNA CASUALTY & SURETY COMPANY,
PETITIONER,

v.

THE UNITED STATES OF AMERICA,
RESPONDENT.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Claims entered on December 17, 1975.

Citation to Opinion Below

The opinion of the United States Court of Claims which denied plaintiff's motion for summary judgment and granted respondent's cross motion for summary judgment is not yet printed in the official reports and is reproduced as Appendix A.

Jurisdiction

The judgment of the United States Court of Claims, printed in Appendix A hereto, was entered on December 17, 1975. The jurisdiction of the Court is invoked under 28 U.S.C. §1255. Petitioner, on December 23, 1975, requested the Court of Claims for a rehearing *en banc* and on January 30, 1976 the Court denied the request.

Question Presented

If a Miller Act surety pays labor and materialmen pursuant to its payment bond and seeks to enforce its equitable right to the contract retainage, may the United States destroy that right by off-setting losses it incurred by reason of its own neglect and failure to require the furnishing of Miller Act payment and performance bonds on a subsequent unrelated contract which it awarded to the same insolvent prime contractor?

Statute Involved

The statute involved is 40 U.S.C. §270a, which provides as follows:

(a) Before any contract, exceeding $2,000 in amount, for the construction, alteration, or repair of any public building or public work to the United States is awarded to any person, such person shall furnish to the United States the following bonds, which shall become binding upon the award of the contract to such person, who is hereinafter designated as "contractor":

(1) A performance bond with a surety or sureties satisfactory to the officer awarding such contract, and in such amount as he shall deem adequate, for the protection of the United States.

(2) A payment bond with a surety or sureties satisfactory to such officer for the protection of all persons supplying labor and material in the prosecution of the work provided for in said contract for the use of each such person. Whenever the total amount payable by the terms of the contract shall be not more than $1,000,000 the said payment bond shall be in a sum of one-half the total amount payable by the terms of the contract. Whenever the total amount payable by the terms of the contract shall be more than $1,000,000 and not more than $5,000,000 the said payment bond shall be in a sum of 40 per centum of the total amount payable by the terms of the contract. Whenever the total amount payable by the terms of the contract shall be more than $5,000,000 the said payment bond shall be in the sum of $2,500,000.

Statement of the Case

Petitioner became the Miller Act surety for J. C. Corrigan Company, Inc. on ten contracts awarded by the United States from June 14, 1968 to June 27, 1969 in accordance with 40 U.S.C. §270a.

On December 30, 1969, the United States awarded an unrelated contract to the same Corrigan Company at Milwaukee, Wisconsin, but neglected and failed to have Corrigan furnish payment and performance bonds as required by the Miller Act. It did not discover its error until April 1971 when Corrigan was becoming insolvent, and thereupon terminated Corrigan on May 10, 1971.

In the meantime, petitioner commenced paying labor and materialmen on the ten bonded contracts in May 1971. It paid a total of $234,704.36, and sought equitable re-

imbursement from a retainage of $77,094.61 on five of the contracts.

On the unbonded Wisconsin contract, the United States claimed offsets of excess cost to complete of $58,691, and a judgment for $61,281.80 plus interest obtained against the United States on December 7, 1973 by an unpaid subcontractor, Kennedy Electric Co. The United States claimed these amounts as offsets so as to wipe out the $77,094.61 retainage on the bonded contracts.

Reasons for Granting the Writ

The United States Court of Claims decision involves an important question of federal law pertaining to government contracts which has not been decided by this Court: whether a failure by the government to obtain Miller Act payment and performance bonds as required by the statute will permit it to use its resultant losses as an offset against the legitimate claims of a surety to the retainage on an unrelated properly bonded contract.[1] An affirmative answer will obviously affect the costs of government contracts because sureties on bonded contracts will inevitably have to consider as a part of premium charges the fact that they may, in practical effect, be forced into also being unwilling sureties of losses incurred on unrelated contracts where bonds were not obtained as required.

The decision of the Court of Claims is, at least, in conflict with the reasoning and equitable principles enunciated by

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[1] *The Government Contractor*, Vol. 18, No. 1, January 5, 1976 ¶11 commented in part about the Court of Claims' decision in this case: "Once again . . . the Court of Claims has seemingly committed itself to a position on a controversial legal subject without demonstrating that it is even aware that it is stepping into troubled waters . . . . It may well be urged that a subject which (1) is as important as this one, and (2) has generated such vigorous differences of opinion among respected legal tribunals, deserves a less summary disposition than that provided by the instant decision."

the Tenth Circuit Court of Appeals in *Kennedy Electric Co., Inc.* v. *United States Postal Service*, 508 F.2d 954 (10th Cir. 1974). The Court of Claims applied *United States* v. *Munsey Trust Co.*, 332 U.S. 234 as though it compelled the right to offset under the facts of the instant situation. The Tenth Circuit in *Kennedy Electric*, although the claim was by a subcontractor, and not a surety, nevertheless, denied an offsetting claim of liquidated damages for completion costs, by holding that *United States* v. *Munsey* did not foreclose equitable considerations, and "A court of equity may subordinate a claim because of equitable considerations." 508 F.2d at 957.

Pearlman v. *Reliance Insurance Co.*, 371 U.S. 132 establishes that a surety who pays on a payment bond obtains thereby "equitable rights" in the retained funds. *United States* v. *Munsey Trust Co.*, 332 U.S. 234 does not hold to the contrary, but merely holds that the government could offset against the surety claims it had for a breach of contract by the contractor. As said in *Pearlman*, 332 U.S. at 140, "We held that the Government could exercise the well-established common law right of debtors to offset claims of their own against their creditors. This was all we held."

Munsey Trust thus leaves undecided the important question as to whether the government may set off costs it incurred as a result of its own neglect and failure to secure performance and payment bonds in violation of the Miller Act. Obviously, if it had obtained such bonds, it would have looked to the surety on those bonds and thus would have incurred no such costs to use as offsets against the surety on other unrelated contracts.

Equitable considerations, similar to those applied by the Tenth Circuit in *Kennedy Electric Co., supra*, should prevent the application of such offsets. A private party would not be allowed to offset excess costs on a subsequent

contract, not bonded by the surety, against a surety's rights to retainage on prior bonded contracts. See *Glassman Construction Co.* v. *Fidelity and Casualty Co. of N. Y.*, 356 F.2d 340 (D.C. Cir. 1966), *cert. den.* 384 U.S. 987.

Moreover, the basis of a set-off is grounded upon equitable principles. *North Chicago Rolling Mills Co.* v. *St. Louis Ore & Steel Co.*, 159 U.S. 596, 615. When the government, like an individual, through its own neglect or failure, causes a situation where the government or another should bear the loss resulting from such neglect, every equitable principle demands that the government bear the loss.

In *The Century Indemnity Company* v. *United States*, 236 F.2d 752 (D.C. Cir. 1956), the government made advance payments on deliveries. The contract was subsequently cancelled, but the government negligently paid for some post-cancellation shipments instead of setting off its advances. Repayment was demanded from the contractor but he went into bankruptcy. In denying recovery from the surety on the bond, the Court said, 236 F.2d at 756: "An individual situated as the government here clearly could not recover. It would be unconscionable to permit the Government to do so."

In *Sutton* v. *United States*, 256 U.S. 575, work was done by a contractor beyond the appropriation through mistake of the government. The contractor could not, of course, recover beyond the appropriated amount, but as to a balance of the appropriated sum against which the government sought to assert its superintendence expenses, the Court said at 256 U.S. at 581: "But if, through mistake of the government's representatives, more work is done ... than was contracted for or authorized, the expenses of superintendence incident to the mistake should be borne by the government; and the contractor should not be made to suffer by the depletion of the appropriation. The fund

otherwise available for work actually performed should be applied for that purpose."

We urge, therefore, that this Court should decide the specific point in issue, an issue which has not hitherto been before this Court, and rule that costs incurred by the government as a result of its own neglect to comply with the Miller Act should be borne by the government, and cannot be used as offsets to deplete retained funds at the expense of a surety who has complied with the Act and its obligations.

Conclusion

For the foregoing reasons, petitioner respectfully requests that the Court grant the petition for certiorari.

By its attorneys,

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APPENDIX

IN THE

United States Court of Claims

No. 67-74

(Decided December 17, 1975)

Philip M. Cronin, attorney of record, for plaintiff.
Leslie H. Weisenfelder, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before COWEN, *Chief Judge*, LARAMORE, *Senior Judge*, and BENNETT, *Judge*.

ON PLAINTIFF'S MOTION AND DEFENDANT'S CROSS-MOTION FOR SUMMARY JUDGMENT

COWEN, *Chief Judge*, delivered the opinion of the court:

This case, before the court on the parties' cross-motions for summary judgment, involves a dispute between a Miller Act, 40 U.S.C. §§ 270a-d, payment bond surety and the Government over the surety's right to unpaid contract balances presently being held by the Government. The surety, Aetna Casualty & Surety Company (Aetna), claims that it is entitled to the entire amount of such balances ($77,094.61). Defendant, however, maintains that it has the right to set off against the contract balances certain obligations owed to the United States by the surety's principal, and that these offsets have a clear and absolute priority over any claim that the surety may have. For the reasons set forth below, we find that the Government is entitled to offsets in an amount that exceeds the unpaid contract funds. Accordingly, we grant defendant's cross-motion for summary judgment and dismiss plaintiff's petition.

The facts essential to a decision are not in dispute. In 1968 and 1969, the United States Postal Service (USPS), acting through its predecessor, the United States Post Office Department (POD),[1] entered into ten contracts with the J. C. Corrigan Company (Corrigan) for the construction and installation of mail handling systems at various post offices. Plaintiff, Aetna, was the Miller Act payment and performance bond surety on each of the ten contracts.

In May 1971, upon learning that Corrigan had failed to meet its obligations to subcontractors and materialmen on those contracts, Aetna notified the POD of Corrigan's default and advised the POD that, by virtue of an assignment of the contract funds and Aetna's equitable rights as surety, Aetna was entitled to any contract funds remaining in the hands of the Government. As payment bond surety, Aetna has paid debts owed by Corrigan to the subcontractors and materialmen on eight of the contracts in the amount of $234,704.36.[2] The unexpanded contract funds presently being held by USPS total $77,094.61. Aetna claims, under the doctrine of equitable subrogation, that it is entitled to these funds to reduce the losses it incurred in satisfying Corrigan's obligations to the subcontractors and materialmen. Defendant, however, maintains that under the rule laid down in *United States* v. *Munsey Trust Co.*, 332 U.S. 234 (1947), it has the right to set off against the contract balances certain obligations owed to it by Corrigan.

The primary offsets asserted by the Government rise out of a contract (No. 70–1–00698) that the POD awarded Corrigan on December 30, 1969, for the construction and installation of a mail handling system in the Milwaukee,

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[1] USPS succeeded to the interest of the POD, under the terms of the Postal Reorganization Act, 84 Stat. 719 (1970), on July 1, 1971. All assets and liabilities of the POD were transferred to the USPS. *See* 39 U.S.C. § 2002.

[2] Aetna incurred no losses as a result of its performance bond obligations.

Wisconsin, post office. Although Corrigan was required to file payment and performance bonds within 10 days from the award of that contract, none were ever filed. The POD, however, did not discover Corrigan's failure to file the bonds until April 1971. Thereafter, the POD determined that Corrigan's failure was willful and on May 10, 1971, terminated the contract.

A portion of the work on the Milwaukee contract was subcontracted by Corrigan to the Kennedy Electric Company (Kennedy). On March 3, 1972, Kennedy brought suit against the USPS in the United States District Court for the District of Colorado to recover amounts due for work and materials provided Corrigan.[3] On December 7, 1973, the District Court entered judgment against USPS. *See Kennedy Elec. Co.* v. *United States Postal Service*, 367 F. Supp. 828 (D. Colo. 1973). That judgment, which was affirmed by the United States Court of Appeals for the Tenth Circuit, is now final. *See Kennedy Elec. Co.* v. *United States Postal Service*, 508 F.2d 954 (10th Cir. 1974). The Government has paid $77,415.10 in full satisfaction of the judgment.

As its first offset, defendant claims that it has the right to offset the *Kennedy Electric* judgment against the unpaid contract balances. Plaintiff, on the other hand, contends that the Government's failure to require Corrigan to file payment and performance bonds rendered the Malwaukee contract illegal and, therefore, that any costs incurred by the Government thereunder cannot be claimed as an offset.

We reject plaintiff's contention for two reasons. In the first place, we are convinced that the Government's failure to obtain the required bond did not render the contract illegal. The better view, and the one which we adopt, is that upon the Government's acceptance of Corrigan's bid,

[3] By this time, Corrigan was in bankruptcy. Since there was no surety from whom Kennedy could seek recovery, Kennedy was forced to proceed against USPS.

a valid contract came into existence and that by failing to furnish the bonds within the required period of time, Corrigan breached an existing an enforceable contract. *United States* v. *Pennington*, 228 F. Supp. 374, 375 (E.D. La. 1964); *see United States* v. *Purcell Envelope Co.*, 249 U.S. 313, 319-20 (1919).

Secondly, even assuming the contract was illegal, we are of the opinion that defendant nevertheless is entitled to the offset which it now claims. The practical effect of the *Kennedy Electric* judgment was to require the Government to utilize its own funds to satisfy Corrigan's obligation to its subcontractor, Kennedy. As a result of its having paid Corrigan's obligation, the Government clearly has a claim against Corrigan that must be satisfied. Since Corrigan is now bankrupt, the only source of funds available from which defendant is able to satisfy this obligation is the contract funds it now holds.

It is a well-settled principle that the Government has inherent authority to recover sums illegally or erroneously paid, and that it cannot be estopped from doing so by the mistakes of its officers or agents. *See United States* v. *Wurts*, 303 U.S. 414, 415 (1938); *American Fidelity Fire Ins. Co.* v. *United States*, 206 Ct. Cl. 570, 580, 513 F.2d 1375, 1381 (1975); *Fansteel Metallurgical Corp.* v. *United States*, 145 Ct. Cl. 496, 500, 172 F. Supp. 268, 270 (1959). As this court recognized in *Fansteel Metallurgical Corp.* v. *United States*, 145 Ct. Cl. at 500, 172 F. Supp. at 270:

> [W]hen a payment is erroneously or illegally made it is in direct violation of article IV, section 3, clause 2, of the Constitution. [case citation.] Under these circumstances it is not only lawful but the duty of the Government to sue for a refund thereof * * *.

Defendant's contention that, under the circumstances of this case, it is entitled to recover the losses that it has incurred in satisfying the *Kennedy Electric* judgment from the funds

earned by Corrigan on its other contracts with the Government, is clearly consistent with these cogently expressed mandates.

Plaintiff appears to argue that, since the costs incurred by defendant in satisfying the *Kennedy Electric* judgment result from defendant's failure to comply with the Miller Act, equity should not permit defendant to recoup its losses by setting them off against the legitimate claims of a surety. Plaintiff, however, derives no legal or equitable rights from any action taken or not taken in connection with the unbonded Milwaukee contract. Aetna had no relationship to, nor participation in, that contract. The Miller Act requirement that the contractor file a payment bond is intended to protect subcontractors and materialmen on the particular contract for which the bond is required. *See Kennedy Elec. Co.* v. *United States Postal Service*, 508 F.2d 954, 957 (10th Cir. 1974); *United States* v. *Aetna Cas. & Sur. Co.*, 480 F.2d 1095, 1100 (8th Cir. 1973); *J. J. Henry Co.* v. *United States*, 188 Ct. Cl. 39, 51 n. 7, 411 F.2d 1246, 1252-53 n. 7 (1969). Plaintiff was not a surety on the Milwaukee contract and has no right of subrogation or other equitable right arising out of the rights of those who furnished labor and material for the performance of that contract. Thus, for the reasons set forth above, we conclude that the defendant is entitled to its first offset.[4]

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[4] Defendant claims that it is entitled to offset the full amount of the *Kennedy Electric* judgment. There is some question, however, as to whether defendant is entitled to offset that entire amount or whether that amount must be reduced by any funds from the Milwaukee contract remaining in defendant's hands. The District Court opinion in *Kennedy Electric* indicates that $35,739.47 remains in defendant's hands. *See* 367 F. Supp. at 832. However, since plaintiff has only contested defendant's right to the offset, and not the amount thereof, we find on the record before us that the Government is entitled to offset the entire amount. Even if we were to take into account the $35,739.47, and reduce defendant's offset accordingly, the reduction would not be enough to affect the overall results which we reach.

As a second offset, defendant claims that it has the right to withhold $58,691 to cover Corrigan's liability to defendant for the excess costs of reprocuring the Milwaukee contract.[5] Plaintiff apparently relies again on its illegality argument to defeat defendant's claim. However, as indicated above, defendant has enforceable rights against Corrigan under the Milwaukee contract. Accordingly, defendant is entitled to an offset representing the excess costs of reprocuring the Milwaukee contract. *See United States* v. *Pennington,* 228 F. Supp. 374, 375 (E.D. La. 1964); *Adelhardt Constr. Co.* v. *United States,* 123 Ct. Cl. 456, 459-60, 107 F. Supp. 845, 846 (1952).

Having determined that defendant is entitled to offsets in an amount that exceeds the contract funds remaining in defendant's hands, we conclude that plaintiff is not entitled to recovery. Accordingly, it is ordered that defendant's cross-motion for summary judgment is granted; plaintiff's motion for summary judgment is denied, and plaintiff's petition is dismissed.

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[5] The amount of this offset is established by the contracting officer's final decision, dated January 14, 1975. The decision was not appealed.